UNITED
NATIONS

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Economic and Social Council

Distr.
LIMITED

E/C.10/AC.3/1992/L.3/Add.5
11 March 1992

ORIGINAL: ENGLISH

COMMISSION ON TRANSNATIONAL CORPORATIONS
Intergovernmental Working Group of
Experts on International Standards
of Accounting and Reporting
Tenth session
5-13 March 1992
Agenda item 5

# ADOPTION OF THE REPORT OF THE GROUP ON ITS TENTH SESSION

## Draft report

## Addendum

Rapporteur: L. Nelson Carvalho (Brazil)

## III. PROGRAMME OF WORK OF THE INTERGOVERNMENTAL WORKING GROUP OF EXPERTS ON INTERNATIONAL STANDARDS OF ACCOUNTING AND REPORTING

### B. Discussion of accounting issues arising during privatization, including individual country case-studies

1. The expert from Germany gave a short introduction to the case-study on his country, and pointed out that, prior to unification, the main purpose of privatization in the Federal Republic of Germany had been to reduce the Government's risk of having to provide future financial support to the enterprises privatized. After unification, the objective was to privatize State enterprises in order to transform the planned economy into a market economy with privately owned property.

2. He went on to state that a major problem was the valuation of the enterprises. He felt that the best indicator of the value of an enterprise was the discounted future income from its operations, but that was very difficult to estimate. Enterprises were being appraised on the basis of their "going concern" value in accordance with the Fourth European Community Directive.

3. The expert from ICFTU made a statement about the role of labour in the privatization process for the former German Democratic Republic. Trade unions were represented on the supervisory board of the Trust Agency (Treuhandanstalt) and were involved in privatization strategy and in the sales process for the larger enterprises. Labour productivity in the former German Democratic Republic was approximately one third that in the Federal Republic of Germany, the result of many factors, including the use of obsolescent machinery. When enterprises lost their markets in Central and Eastern Europe, they needed to develop new markets for their goods. Unfortunately, the quality of their products was not up to western standards. That meant that major investments in plant and equipment and management expertise would be required if the enterprises were to operate successfully in a market economy. She was of the opinion that restructuring must, in some cases, precede privatization.

4. The expert from the International Assets Valuation Standards Committee pointed out that the use of similar assets in other cities of the Federal Republic of Germany as a basis for valuing assets in the former German Democratic Republic was risky because in every city the investment climate was different. Another expert inquired about what had been done with social assets such as the sports and recreational facilities that had been owned by enterprises in the former German Democratic Republic. The expert from Germany replied that those assets were either privatized or were turned over to the employees or local authorities.

5. The expert from Hungary described the developments that had occurred since the report on his country had been prepared. The pace of privatization had increased rapidly towards the end of 1991. Approximately 85 per cent of the funds received for privatization transactions were in convertible currencies, which was the main source of foreign capital in that year. In seeking investors, the emphasis had been on obtaining strategic buyers.

6. One important issue was the lack of availability of credit to entrepreneurs. That lack had deterred them from making investments. The Government was working to improve the situation. Interest rates were currently too high. Investment incentives and tax regulations needed to be brought into closer harmony with the new accounting rules. It had been found necessary to restructure enterprises prior to privatizing them. A clear management structure should be established in the enterprises so that they would accept responsibility for their success.

7. With regard to accounting matters, financial statements for 1991 would still be prepared in accordance with the old law of accounting. The new law would become applicable in 1992. Consolidation would not be required before 1995. The new accounting methodology was significantly different from the old accounting rules. The expert noted that the chart of accounts remained, in effect, but that it had been reduced to a broad outline, leaving the exact contents to the company.

8. The observer from Czechoslovakia made a presentation on privatization in his country.

9. Small privatization had been started in the previous year and a programme for large enterprises would begin in the current year. A current valuation of property in all enterprises was not practical because there were so many enterprises. However, those enterprises that were seeking foreign capital would be valued in accordance with international standards. The process should begin in two months.

10. To date, 14,000 enterprises had been sold in public auctions, and 9.3 billion koruny had been received by the Government. There were very few small enterprises left to be privatized. Large enterprises must prepare privatization plans but outsiders might prepare competitive plans for the same enterprises. The Ministry of Privatization had received 5,700 proposals to date.

11. About 4.5 million citizens of the country were expected to participate in the coupon privatization programme. Citizens would buy shares with the coupons, for that was the quickest way to find new owners.

12. The observer from Poland commented on the excellence of the case-study of her country. After initial criticism, the Parliament had voted in favour of the mass privatization scheme, and the Minister of Privatization had been given approval to proceed with transforming State-owned enterprises into joint stock companies. At the time, there were approximately 23,000 enterprises in the private sector, 1,400 joint ventures with foreign investors, and 4,500 partially State-owned joint stock or limited liability companies. During 1991, six large enterprises were privatized through public offerings and their shares quoted on the Warsaw stock exchange, and 18 large firms were sold directly to foreign investors.

13. The development of a transparent and efficient capital market was a key element in the institutional framework required for the success of privatization. The training of board members, managers and capital-market participants was also crucial to the implementation of the programme. The free distribution of coupons and the purchase of shares in privatized enterprises with those coupons would increase the private property owned by Polish citizens. Dividends on shares would add to household incomes, and therefore overall spending would increase.

14. After discussion of the seven case-studies, two experts offered information on privatization in their countries.

15. The expert from Brazil offered a brief presentation on the privatization programme currently in process there. The objectives of the programme were to achieve equilibrium in public finances, to eliminate ownership by the State in activities where it was not required, and to reduce inefficiencies. About 130 enterprises had been identified at the national level. A decision was reached to privatize the large enterprises first in order to build confidence in the programme. Initially, the programme had been opposed by certain minority groups, but currently there was popular support. The steel industry was the first one selected, and aircraft manufacturing and petrochemical industries would be next.

16. Economic and financial appraisals were being made for each enterprise to be privatized. Accounting for the effects of inflation was being performed according to ISAR conclusions. The enterprises were audited, and in addition, a special audit of the privatization process was being carried out to ensure transparency. Minimum guidelines for such work had been established by the Brazilian Institute of Accountants, in cooperation with the Federal Council of Accountants and the Brazilian Security Commission.

17. The expert from Chile pointed out that three programmes had been carried out to date in Chile. The most recent, between 1984 and 1986, was directed towards expanding the capital market in the country and increasing the number of citizens who owned shares in enterprises.

18. A special State agency was organized to carry out the programme. State-owned enterprises, primarily in the service sector, were organized as corporations, as a first step. The enterprises were then privatized, primarily by management/employee buyouts, public-share offerings, trade sales and debt-equity swaps. Pension funds, which had been privatized in 1981, were able to acquire a percentage of shares in order to allow them to maintain a well diversified portfolio. That had contributed to the economic growth and development of the Chilean securities market.

19. An expert expressed the view that one issue for developing countries was the extent to which interests in national enterprises should be sold to foreign investors. The expert from Chile agreed, and stated that the Government was seeking foreign investment as part of the programme. Nevertheless, the Government maintained control over strategic enterprises.

20. The Group next took up the summary report. The expert from India felt that guidance was needed in the following areas: (a) preparatory work required before privatization; (b) how valuations should be performed and what safeguards were necessary so that overvaluations and undervaluations did not occur; (c) post-audits of privatization transactions; and (d) post-evaluations of privatization transactions to determine whether the Government's objectives had been met.

21. The expert from Morocco noted that the case-studies were of countries with well established market economies and countries in transition to a market economy. The problems of other countries, particularly those in Africa, were quite different, because the Government was the only economic agent capable of operating productive enterprises after decolonization. The expert from India suggested that a case-study on the Indian experience would be useful to countries that were involved with privatization.

22. Another expert said that there should be a specialized body in each country to insure that privatizations conformed with the long-range governmental objectives. That body should also classify the risks involved in order to maintain public confidence in the securities market. Future insolvencies could cause serious harm to investors.

C. Preparation for the 1993 session on education and training in developing countries and countries in transition

23. At its 9th and 10th meetings on 11 March 1992, the Group took up consideration of two reports on accountancy development (E/C.10/AC.3/1992/6 and 7). First, it discussed the results of the International Conference on Accountancy Development in Africa, held from 14 to 17 October 1991 in Dakar, Senegal, which was organized by the United Nations Centre on Transnational Corporations and the Federation internationale des experts-comptables francophones (FIDEF). The Conference was also supported by the International Labour Organisation, the World Bank and the International Federation of Accountants (IFAC).

24. The Conference was the first occasion at which so many representatives of the accounting profession - from both developed and developing countries, international organizations, Governments, and other interested parties - were gathered to discuss accountancy development in Africa. The purpose of the Conference was to discuss with interested parties the findings of the survey of accounting needs in Africa, to identify strategies to strengthen accountancy development in Africa, to formulate project proposals and to select projects which could meet the needs of the countries concerned. Fourteen projects were reviewed in three areas:

(a) Accounting standard-setting and research;

(b) Strengthening of the profession;

(c) Accounting education and training.

25. The observer from FIDEF stated that he could not recall another conference which had gathered together so many experts from so many places. Besides broad African representation, there was a large number of international agencies in attendance. Furthermore, the Conference had been an important launching point for a flood of activities. Fourteen projects had been discussed, and it would be a pity if no further action were taken on them. The spirit of the Conference must be maintained and the project proposals should be improved. Therefore, an advisory board should be set up to finalize the proposals and seek funding. A number of experts agreed that it was important not to lose the initiative and that the projects must be followed up on. The representative from the World Bank stated that all the proposals deserved a response, that they all had merit, but that they needed amplification in order to meet donors' requirements. He called for a task force to be mobilized.

26. The expert and Executive Director of the International Federation of Accountants reported that the Education Committee had met and decided to develop a project based on a recommendation made at the International Conference. The Committee felt that it might be able to improve the quality of African education by instituting a process whereby it reviewed the curriculums of African institutes and universities and then issued a statement

that the curriculums complied with its educational guidelines. Such a proposal would have to be approved by IFAC's Governing Council. He said that such an exercise would have to start slowly, so that it would be done correctly. Therefore, only a few African countries would initially be selected for the project.

27. Regarding further work, the Group decided that an ad hoc working group should be created with members from developing countries, developed countries and international organizations. It would take the following actions:

(a) Further analyse and refine the project proposals in light of the findings of the Africa survey, the project assessments made in Dakar and the suggestions for additional ways and means of improving project design and assessment, as described in the report;

(b) Contact country representatives concerning additional questions that might arise and possible project restructuring and redesign;

(c) Organize programming missions. Once possible pilot projects have been identified and a preliminary selection made, missions would be undertaken by one international expert and one national expert. They would identify all appropriate participants, both national and international, and would draw up the final project design and a plan of action, including the responsibilities of all parties;

(d) Organize a consultative meeting (of the proposed ad hoc working group) to which all interested parties would be invited, in order to discuss and evaluate project proposals; "brainstorm" additional ways and means of improving product design and assessment, as described in the report; discuss and agree on a coherent strategy for the further development of national versus regional accounting projects; select pilot projects; and seek funding for them.

28. The Group next turned its attention to a review of accountancy education and training programmes in Central and Eastern Europe (E/C.10/AC.3/1992/7). Since there were no published sources of such information, it had to be gathered organization by organization. The report was a first attempt to centralize and share information so that cooperation and coordination could be improved among international and other donor agencies. The earlier discussions on privatizations had highlighted the need for such training. Programmes that took into consideration local needs and the background and experience of the trainees, which were designed in conjunction with local experts, which incorporated recent national accounting reforms and which were designed to be self-sustaining were more likely to produce an appropriately educated cadre of accountants, managers and educators and thus facilitate the transition to a market economy.

29. The experts from the countries in transition were invited to share their experiences. The expert from the Russian Federation said that present educational efforts in her country were totally insufficient and that

accountants had an inadequate understanding of their new role. Previously accountants had been regarded as State comptrollers. However, now they would have to be creative, to make choices and to take decisions in the enterprises. She reported that before the education programme sponsored by the United Nations Centre on Transnational Corporations had been offered at Moscow State University, the best students were not attracted to accounting. However, the courses and the subsequent job opportunities had changed their attitude towards accounting. She urged that there be greater coordination of such programmes among international donors so that the programmes could be speeded up.

30. The representative of the EC stated that the Community wanted countries to define their needs so that it could then decide upon appropriate action. It was important that the initiative come from the country itself. The EC tried to be objective, to include as many member States as possible and to put all projects out to tender.

31. The expert from Czechoslovakia stated that it was very difficult for foreign instructors to teach accountants in his country what they needed to know. Foreign instructors were not familiar with the Czechoslovak legal system or new accounting law. In some cases, the programmes seemed to help foreign accounting firms more than Czechoslovak accountants. He also noted that when accountants were retrained, they often left government or university service to work in private accounting firms. The Russian experts replied that one had to compare the costs and benefits. It was impossible to avoid all the costs of such a programme. The benefits were great. The costs or losses could be borne as long as the general level of accountancy increased.

Annex

LETTER FROM THE CHAIRMAN OF THE INTERGOVERNMENTAL WORKING GROUP ON ITS TENTH SESSION TO THE SECRETARY-GENERAL OF THE UNITED NATIONS CONFERENCE ON ENVIRONMENT AND DEVELOPMENT

12 March 1992

Dear Mr. Strong,

As Chairman of the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR), at its tenth session, I was assigned the duty to transmit to you, on behalf of the Group, its conclusions on corporate environmental accounting and reporting. The Group, which reports to the Economic and Social Council, is currently composed of 31 member countries, of which 19 are developing countries. The experts who represent their Governments are regulators, auditor-generals, or practising accountants. For the past three years the Group has undertaken an extensive analysis of corporate accounting and reporting relating to environment disclosures.

In its latest study of 222 transnational corporations (which is enclosed) the Group found a high awareness of environmental issues. Of the transnational corporations surveyed, 89 per cent provided some information regarding their environmental impacts. However, despite the high awareness, much of this information is qualitative or descriptive, and there is no consistent pattern of disclosure. One of the main problems is that the environmental results achieved are not related to expenditures or to environmental targets.

The Group requests that its conclusions be considered for inclusion in Agenda 21 so that they may be brought to the attention of Governments and other interested parties. In particular, the Group believes that its work is relevant to chapter 7 of said Agenda 21: Integration of Environment and Development in Decision-making. Since chapter 7 deals with national income accounting, special subtopics on corporate environmental accounting should be considered for inclusion. The Group is prepared to furnish you with its reports on the subject. The Group believes that technical assistance might be necessary to assist national standard-setters to implement guidelines in the area.

The Group is of the opinion that these conclusions, if followed, would produce consistent and comparable information in the financial statements. Disclosure of such information is likely to have a positive impact on corporate environmental policies and programmes. Experience has shown, for example, that the publication of toxic emission data has had a more powerful effect on reducing pollution than 20 years of regulation.

I set out the Group's conclusions on the following pages.

Thank you in advance for your attention and cooperation. I would appreciate your response to the Group's initiative so that I may communicate it to the Commission on Transnational Corporations and the members of the Group.

Sincerely yours,

Dr. Istvan Friedrich
Chairman
Tenth session of the
Intergovernmental Working Group
of Experts on International
Standards of Accounting and Reporting

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